SUMMARY OF COMMENTARY ON CURRENT ECONOMIC CONDITIONS
BY FEDERAL RESERVE DISTRICTS

June, 1984

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SUMMARY*

Overview

The pace of economic expansion appears to have slowed recently. Retail sales are strong and retailers are optimistic. Manufacturing activity continues to rise but at a reduced pace from earlier this year. Retail and manufacturer's inventories appear to be close to desired levels. No strong upward price pressures are reported. Sales and starts of new houses are slowing. Rising interest rates and adverse weather are reported to be hurting the farm sector. Loan demand continues to grow in most districts.

Retail Sales

Retail sales for May and early June are reported to be strong and better than expected in most districts. Year-over-year gains of between 10% and 20% are common. Sales of summer apparel, fans, air conditioners, outdoor furniture and grills were stimulated by exceptionally hot weather in the east. Minneapolis reports sales, depressed by cold weather in May, are firming in June. Inventories are generally at satisfactory levels, although a few districts report them to be slightly larger than desired. Retailers are optimistic about the outlook for sales during the remainder of 1984.

Automobile sales continue to be strong, although St. Louis notes that sales are sluggish at some dealers. San Francisco reports auto sales, at their highest level since the late 1970s, are being supported by subsidized

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*Prepared at the Federal Reserve Bank of Cleveland financing by dealers, and some auto dealers in the Cleveland district say that consumer lending rates haven't risen enough to damp sales. St. Louis observes that small cars are selling better than large cars, and Minneapolis reports recreational vehicles selling exceptionally well.

Manufacturing

Manufacturing activity continues to expand, but at a slower pace than earlier this year. Manufacturing employment is rising slowly in most districts. Production of aluminum, paper, tires, heavy-duty trucks and trailers, and medium- and full-sized cars is reported by various districts to be at full capacity. Demand for electronic equipment continues its strong growth. San Francisco reports lumber producers are cutting payrolls because of the national homebuilding slowdown, and Atlanta adds that softening housing demand has also cut the furniture industry's demand for lumber. Various districts report foreign competition is crimping production of copper, steel, furniture, and machine tools. Dallas, however, notes strong production growth and lengthening lead times for primary metals. Modernization and cost cutting are still emphasized in capital investment but there are a few reports of capacity expansion. Boston reports demand for capital goods used by the energy, steel, and farm equipment industries remains depressed. Inventories are generally near desired levels and are growing slowly. There are only a few reports of shortages and lengthening lead times. Price increases are being restrained by vigorous domestic and foreign competition. Cleveland reports that major steel producers expect little or no profit this year because of weak prices.

Construction and Real Estate

Sales and starts of new houses slowed in May and early June in most districts in response to rising mortgage interest rates. Chicago reports lenders have tightened credit standards. San Francisco notes the slowing has been moderated by "increased public acceptance of adjustable rate mortgages and the increased offerings of 'buy-down' programs by builders." Dallas observes caution in multifamily construction because of fears of overbuilding, but St. Louis reports some building of apartments.

In contrast, New York reports house sales and starts are so strong that some builders have "suspended" sales because they are producing at capacity, and Richmond says the trend in housing construction is quite strong.

Nonresidential construction is reported to be strong by San Francisco and New York, "active" by Minneapolis, and down by Atlanta. Dallas reports a decline in permits for nonresidential construction.

Atlanta reports lumber prices are falling while Kansas City reports price increases for sheetrock and cement. According to Chicago, a shortage of gypsum board has ended because builders and distributors have stopped adding to inventory. Dallas comments that the high level of construction has some lumber, concrete, and brick plants running multiple shifts.

Agriculture

The agricultural sector is reported to be hurt by rising interest rates and bad weather. Reports of adverse weather are widespread. Droughts, blizzards, and excessive rain are reported to be hampering agricultural production. Minneapolis comments that many counties in that district have been declared disaster areas because of weather. San Francisco notes that abundant vegetable harvests have pushed prices to or below the break-even point for many producers. Rising interest rates and weak income prospects are reported to be placing extreme financial pressure on some farmers. Minneapolis reports that it is increasingly difficult for banks to find acceptable agricultural loans. In the St. Louis district, this year's crops are reported to be "critical" to the financial survival of many farmers. Kansas City says bankers in that district are concerned by the "increasing number of farm bankruptcies."

Energy

Cleveland reports coal production is rising as users increase inventories as a strike hedge. Richmond reports coal output has risen significantly in 1984 but is facing strong foreign competition. San Francisco reports the coal industry is laying off workers because of foreign competition. Dallas reports oil drilling activity is substantially above the year-earlier level, and drill pipe inventories have fallen to desired levels. Atlanta reports better prospects for its energy sector because of "sharply lower drilling costs" and rising demand for oil.

Commercial Banking

Several districts report commercial and industrial loan demand is growing strongly. Philadelphia says commercial and industrial lending has been "especially strong" in the last six weeks. An exception is Cleveland where business lending has not expanded in the last month. Consumer installment lending is "brisk" in Philadelphia and "robust" in Cleveland, but down in St. Louis. A few districts report rapid deposit growth and Atlanta says banks are very liquid. San Francisco notes a large runoff of funds from money market deposit accounts. Two districts comment on the safety of deposits: St. Louis reports that "a few corporate treasurers have expressed concern about banking problems, and have lowered some balances to decrease exposure at any one institution," and San Francisco notes that some depositors at a few smaller institutions have shifted some deposits into U.S. Treasury securities.

FIRST DISTRICT - BOSTON

The expansion continues in the First District. Retail sales are strong. Manufacturers report that business is generally good, although some think that the rate of growth has slowed. Inventories have increased in both retail and manufacturing sectors; respondents do not consider this worrisome, however. Price increases continue to be moderate.

Retail

Retail sales in the First District grew strongly in May and June. Inventories remained at satisfactory levels. Contacts reported no signs of increased inflation, although one firm mentioned difficulty hiring because of tight labor market conditions. The outlook was optimistic.

Sales reported by First District merchants for May and June ranged from 10 to 40 percent ahead of last year on a comparable stores basis. Toys, promoted apparel, and summer hardgoods were especially strong. Sales of summer furniture, grills, and appliances accelerated during a spell of extremely hot weather throughout the Northeast. A national chain reported their New England stores' pace is no longer far ahead of other regions, not because New England is slowing but because stores elsewhere are picking up.

Several retailers mentioned that inventories were somewhat above plan or above last year, but this was appropriate to the volume of goods being sold. One chain with booming sales has rented additional inventory warehouse space so that it can continue to service customers quickly.

Price increases are quite moderate in general (under 5 percent), and prices are declining for electronic items. One department store reported "very competitive" conditions for apparel, with more frequent promotions than in earlier years.

Manufacturing

Manufacturing activity in the First District continues to expand, although several respondents think that the rate of growth has slowed. Government work is an important source of strength and is expected to remain so for the foreseeable future, regardless of the election. The demand for computers and related products is strong, although individual firms are experiencing difficulties and some suppliers are losing sales to foreign competitors.

Appliances and other housing-related products are doing well, as are automotive products. Demand is increasing for capital goods in general, but remains depressed for the large, long-cycle capital goods purchased by the energy, steel and farm equipment industries. However, several respondents noted that the commercial aircraft industry seems to have turned the corner.

The major concern of First District manufacturers is foreign competition in both domestic and international markets. One respondent comments that he faces direct competition from imports, his customers are moving overseas and buying from local suppliers, and other customers located in the United States are losing market share to imports. The dollar is seen as the primary reason for reduced competitiveness. On a more positive note, several respondents report that exports are picking up after a slow start.

Inventory-sales ratios have increased and are slightly higher than desired. Manufacturers became more confident about the strength of the recovery and more concerned about missing out on sales. They decided to build up their inventories a bit, but a slight slowing in the rate of growth left them with higher ratios than anticipated. This is not seen as a problem.

Price increases are more numerous but remain modest, ranging from 2-5 percent. Buyers are said to be very choosy and several respondents have had to back down from proposed price increases.

Respondents attitudes towards capital spending seem to be more varied than in past months. The emphasis in capital spending is still on productivity improvement and particularly on making a lot of fairly small changes to boost productivity. Several respondents emphasized their conservative approach to investing. However, in a departure from the recent past, several said they are expanding or making major investments in new production technologies.

SECOND DISTRICT--NEW YORK

Introduction

The pace of the recovery in the Second District stabilized in May and early June. Business activity continued to expand in most sectors of the District, and the unemployment rate fell in New Jersey and remained below the national average in New York. Purchasing agents generally reported stable or improved business conditions, a number of manufacturers were planning to modernize or expand their facilities, and banks throughout the District reported rapid growth in business loan demand. Construction activity was strong and, in the residential sector, was at full capacity in some parts of the District. Consumer spending continued to meet or exceed retailers' expectations.

Consumer Spending

Department stores in the Second District posted better than expected sales gains during the month of May, as consumer spending continued at the fast pace set in April. Though increases over last year varied from four to twenty-one percent among individual retailers, in most cases the volume of sales met or exceeded expectations. Retail sales during the first two weeks in June were also quite strong.

Inventories at the end of May remained at high levels for many retailers, ranging from fifteen to thirty percent above those posted last year. Some retailers view these levels as too high and have responded with markdowns and promotions. Other chains, however, have deliberately increased stocks because strong consumer demand is anticipated.

Business Activity

Growth in District business activity has continued, but at a somewhat slower pace in recent weeks. The percentage of purchasing agents reporting improved business conditions declined in May from April's record levels, and the percentage reporting higher inventories rose. Nevertheless, most agents experienced stable or improved business conditions, and they generally viewed the inventory buildup as reflecting increased confidence in the strength of the local economy.

The District continued to have a greater share of its labor force at work than the nation as a whole. In May, New York State unemployment remained at the April rate of 6.7 percent, and New Jersey unemployment dropped a full point to 5.7 percent. The rate in New York City dropped slightly to 7.6 percent on an unadjusted basis.

Several recent announcements pointed to additional economic gains in various parts of the District. Plant shutdowns planned for northern New Jersey and Westchester have been cancelled; instead one plant will be modernized and the other will be converted to mixed industrial uses. In addition, a $100 million plant expansion has begun in New Jersey and on Long Island a $126 million International Design Center project has been initiated.

Construction and Real Estate

Residential construction activity remained very strong throughout the District. However, limited building capacity has reduced the pace of sales in spite of continued high levels of demand. In fact, some builders in parts of the District have suspended sales because they are unable to accommodate more business.

Non-residential real estate activity was strong in most parts of the District. In lower Manhattan, major institutions continued to seek large amounts of office space, although some securities dealers and financial institutions have been moderating their expansion plans.

Long Island commercial and industrial construction was active, and its relatively low rents continued to lure companies from New York City. Construction also remained brisk in New Jersey although sizable amounts of space are currently available. Construction in lower Connecticut leveled off, and activity in the northern suburbs of New York remained low.

Financial Developments

During the past several months small banks in the Second Federal Reserve District experienced rapid growth in business loan demand. The reasons cited for the increase were the strength in the local economy, inventory accumulation, and leveraged buyouts of local business. Some of the regional bankers, however, expect loan demand to taper off in the next few months if the local economy slows down as expected or if there is another hike in the prime rate.

THIRD DISTRICT - PHILADELPHIA

Contacts in the Third District say the business environment is still healthy, although some signs of a weakening of the expansion are appearing. Retailers have posted significant sales growth and bank contacts report continuing healthy increases in both commercial and retail lending. Manufacturers, on the other hand, indicate increases in activity which are softer than those of the first quarter, and real estate contacts have seen a sharp slowdown in sales over the past six weeks.

The outlook for the remainder of 1984 reflects a similar pattern. Retailers and bankers are forecasting strong growth for the rest of the year. Manufacturers anticipate continued growth, but are increasingly less enthusiastic, and realtors foresee a prolonged slump in their industry, barring an unanticipated decline or leveling-off of mortgage rates.

MANUFACTURING

Respondents to recent Business Outlook Surveys report healthy growth in manufacturing activity for May and June, although the portion of respondents reporting increases continues to slip. The June survey finds 37 percent indicating an increase in activity over May levels and 8 percent noting a decline. Specific indicators also have posted less robust increases in June than in May. While new orders and shipments continue to advance, producer backlogs and delivery times are unchanged. Additionally, employment has edged upward only slightly and inventory levels are just fractionally higher than in May.

Although respondents are not as enthusiastic as they were in the first quarter, the outlook for Third District manufacturing activity remains bright. Almost half of the manufacturers surveyed predict expansion through the end of 1984, while only 16 percent foresee a decline. Executives polled expect healthy growth in new orders and shipments, yet predict little change in either employment or inventory levels.

Industrial prices have risen again in June, but, as in May, the percentage of respondents indicating higher prices has fallen — 37 percent (compared to May's 42 percent) report paying higher prices this month, while 14 percent (18 percent in May) say they are receiving more for their finished products. The outlook, however, continues to reflect widespread anticipation of higher prices over the next six months. In June's survey, 77 percent of the respondents are forecasting higher input prices by year-end and 57 percent feel they will be receiving more for their output.

RETAIL

Third District merchants continue to enjoy excellent sales growth in mid-June. Retailers report 10-percent to 25-percent increases in May over year-ago levels, and they expect similar results for June if sales hold up after Father's Day. The performance is attributed partly to heavy promotions in May, along with unseasonally hot weather in early June. The heaviest sellers have been "hot weather" apparel and appliances, such as fans and air conditioners. Inventory reports vary, but stock levels generally are said to be a little heavy, though not enough to warrant extensive markdowns.

Retailers say that a combination of continued strength in consumer demand and extensive promotions will result in strong sales growth for most of the remainder of 1984, and project 8-percent to 20-percent increases in sales over 1983 levels. Some merchants anticipate a definite easing in the general economy and a respective slowdown in retail growth toward the end of the year.

FINANCIAL

Third District bankers continue to report significant loan growth in both the commercial and the retail sectors. C&I activity has been especially strong in the past six weeks, with contacts indicating growth between 2 and 3 percent since mid-May. Commercial loans outstanding are currently running 15 percent to 25 percent above comparable periods of a year ago. Most bankers also report continued strength on the retail side. Currently, credit card and general installment lending are setting the brisk pace, while mortgage activity has been slowing.

The outlook for loan activity through 1984 is a positive one. Although contacts express mixed views over whether the current increases in C&I loans can be sustained, the majority feel that demand is strong enough to keep loans outstanding 10-to-15 percent higher than year-earlier levels throughout the remainder of 1984. On the consumer side, forecasts are generally positive, although some bankers see rising rates occasionally interfering with otherwise widespread consumer demand for bank credit. Specifically, they note the possibility of "bargain" financing packages offered by auto dealers cutting into the retail lending market.

The prime rate at Third District banks is currently 12-1/2 percent, up from 12 percent six weeks ago. Interest rate forecasts of local bank economists have changed very little since the last report; most contacts foresee gradually, but steadily, increasing rates through the end of the year. The prime is expected to move to 13-1/2 percent and the federal funds rate to 12 percent by the end of the fourth quarter.

REAL ESTATE

Third District real estate activity has slowed considerably since the beginning of June, according to contacts. Although some realtors say sales were fairly good through May, one local builder reports that activity has been flat for the past six weeks. Rising mortgage interest rates are mentioned as a key factor, if not the only factor, in causing the slump. Rates on 30-year, 3-point, fixed rate, conventional mortgages have climbed 50-75 points since late April and currently range from 14 percent to 14-3/4 percent. Consequently, about half of all new homebuyers are financing their purchases with adjustable rate mortgages. Realtors and builders believe that if mortgage rates fell, or simply held steady, for several months, activity would pick up. With rates forecast to rise even further, however, contacts expect the sales drought to continue.

FOURTH DISTRICT--CLEVELAND

Summary

The District's economy continues to strengthen but the unemployment rate remains stubbornly high. Retail sales have been strong. Manufacturing activity continues to increase but many major steel producers are not yet generating profits. Coal demand is rising but remains at a low level. Residential construction and house sales are slowing. Business lending has not expanded recently but bankers expect strengthening soon.

District Labor Market Conditions

The labor market is displaying mixed trends and unemployment remains high. Employment and unemployment have risen in the last three months and the unemployment rate has risen from 9.3% in February to 10.2% (s.a.) in May. Although the unemployment rate has declined 3.2 percentage points from a year ago, in May it stood 2.7 percentage points above the national rate.

Unemployment rates in eleven major metropolitan areas in this District in April ranged from 7.8% in Columbus to 12.0% in Youngstown. Manufacturing employment continues to rise but the average workweek in Ohio manufacturing in April, 42.5 hours (n.s.a.), was at the same level as in November 1983.

Retail Sales

Retail sales remained strong in May, with general merchandisers reporting year-over-year gains of 9% to 13%. Although these increases represented some moderation from earlier in the year, several retailers noted that they were above internal projections for the month. Moreover, the May gains were largely accomplished without an unusual number of promotions. One retailer however, suggested that some of the May strength may have been due to demand for seasonal goods that had been depressed by adverse weather during the March-April period. The inventory buildup that resulted from the March-April slowing in sales has been of little concern to District retailers because inventory-to-sales ratios remain at acceptable levels. District merchandisers expect retail sales gains to slow cyclically over the months ahead and are building inventories in line with those expectations. Most area auto dealers report virtually no easing in demand for domestic or foreign cars. They report that consumer lending rates haven't risen enough to have an effect on sales.

Manufacturing

Orders, employment, output and prices continue to rise. A survey of northeastern Ohio purchasing managers indicates production, employment and prices paid rose faster in May than in April and new orders accelerated in May after three months of slowing gains. Inventories of supplies and materials continue to grow and some managers report they are increasing stocks to hedge against price increases and slower deliveries. A survey of Cincinnati area purchasing managers indicates production and new orders are rising at a steady rate, employment growth is slowing, and order backlogs are falling slightly. Inventories of supplies and finished goods show little change. Vendor performance continues to worsen, and prices paid for commodities continue to rise but at a slower pace than earlier this year. A survey of financial officers of major midwestern manufacturing firms indicates new orders continue to increase at the same rate as in the first quarter while inventories are rising at an increasing pace.

Primary Metals

A major steel producer reports effective capacity has increased since early spring and customer inventory growth has slowed; therefore, the industry is no longer producing flat rolled steel at current effective capacity. Output of flat rolled steel is likely to be reduced in the third quarter because of further auto industry model changeovers and because steel service centers will be reversing their recent excessive inventory buildup. Demand for steel plate remains weak. Overall, the domestic industry has the ability to ship 95 million tons of steel per year but is expected to ship only 77 million tons in 1984 and 83 million tons in 1985. Prices are not rebounding as they usually do during an economic expansion. Prices charged by major steel producers remain weak because of competition from imports and domestic minimills. Major steel producers had losses in the first quarter and may break even in the second quarter but little profit is expected before 1985.

A major aluminum producer reports that some softness in order rates has developed recently. Spot market prices for ingot aluminum continue to decline.

Coal

Demand for coal has increased recently because some users are building stockpiles in anticipation of a possible strike by the United Mine Workers, but the levels of demand and production remain low.

Housing

Residential construction activity is showing signs of slowing significantly from its rapid first quarter pace. Builders are experiencing a downward racheting in new orders, despite undiminished buyer traffic. Demand in the move-up market is becoming quite weak because of recent rises in mortgage interest rates. Realtors, who were very bullish at the beginning of the year, are experiencing a steady decline in listings, a moderate rise in the average length of time a house is on the market, and a significant increase in closing time.

According to mortgage lenders, prospects for high and climbing interest rates portend a gloomy housing outlook. Borrowers increasingly are becoming wary about adjustable rate mortgage (ARM) instruments because of recent negative publicity. Lenders expect ARM demand to weaken moderately in the next two months, and doubt that ARMs can sustain the robust pace of housing much longer.

Commercial Banking

Loan demand appears to have weakened at Fourth District banks in recent weeks. Although the demand for consumer installment loans was robust, there was no further expansion in business lending. Nevertheless, bankers generally expect both consumer and business loan demand to be strong throughout the year.

Deposits increased at a strong pace during the last month. It appears that District banks relied primarily on these funds to finance loans since their holdings of large certificates of deposits and borrowed funds did not increase during the last month.

FIFTH DISTRICT - RICHMOND

Overview

Once again, most available evidence points to continued economic expansion in the Fifth District. Recent strength appears to be concentrated in trade, services, and construction, however, and seems to be largely seasonal. New order growth in the manufacturing sector has clearly slowed in recent weeks, although some firms and industries are still showing significant gains. Also, momentum from order backlogs and inventory accumulation is still supporting production levels. Activity in the housing sector, despite some month to month fluctuations, appears to be holding to the robust trend established earlier in the recovery. Nonresidential construction is also lending continued support in the District. In addition, growth of loan demand in both the business and consumer sectors is quite strong, and is generally expected to remain so. By and large, there are no major factors that seem likely to put upward pressure on costs in major District industries over the remainder of the year.

Manufacturing

Despite some slowing of new order growth in recent weeks, District manufacturers, on balance, appear to have continued expanding output. Shipments have continued to grow as order backlogs have become abnormally large in some industries. Also, there continues to be some emphasis on inventory building, although most intentional accumulation has probably already taken place.

Some of the District's major industries are facing significant competition from foreign producers and are losing ground in both domestic and world markets. Among manufacturing industries, textiles and apparel and furniture are prime examples. Both industries have expanded output substantially over the past year, but have lost ground to imports in domestic markets. Coal is the major example in the nonmanufacturing area, having raised output significantly in 1984, but with little or no gain in exports, which fell sharply in 1983. It seems likely that both output and prices in these industries will be constrained throughout 1984 as a result of foreign competition.

Consumer Spending

Consumer spending activity is still quite strong, although big ticket items do not seem to have contributed their share in recent weeks. Sales of general merchandise and services are carrying the load for the time being. The apparent lull in durables is generally thought to be transitory. Consumer balance sheets are perceived as being in good order and consumers seem no less willing to take on additional debt despite the recent rise in outstandings and interest rates.

Housing and Construction

Housing and construction are still bright spots in the District economic picture in spite of some sizeable month to month fluctuations in residential sales and construction activity. The trend in housing construction around the District looks quite strong, and sales of new homes are sufficient to keep it that way. Speculative building of homes offers further support to the industry. Unsold units, new or otherwise, seem to be well under control in most areas, although larger numbers are coming to market.

Banking and Finance

Loan demand has grown quite rapidly in recent months and has generally outstripped deposit growth at District financial institutions. Nonetheless, most institutions seem to feel able to expand loans somewhat more relative to deposits, and many are convinced they will have ample opportunity to do so. They are projecting loan growth in excess of deposit growth, with considerable strength coming from both business and consumer sectors.

There is little feeling around the District that current debt levels represent an impediment to further consumer borrowing. In addition, there is no apparent consensus regarding how recent interest rate increases will affect the pattern of consumer credit activity in coming months.

The Outlook and Prices

More and more, respondents around the Fifth District seem to feel that the economic expansion has nearly run its course. There is little support, however, for the view that any sort of contraction is imminent. For the most part, our respondents are expecting only a leveling off of business activity.

There do not seem to be major sources of cost or price pressures emerging in District industries. Of course, the coal industry is currently involved in negotiating a new contract, and the recent strength in domestic markets might raise the miners' expectations. Also, major collective bargaining contracts in the apparel industry expire next year. However, in these cases, as well as in the textile industry, foreign competition is likely to impose some restraint, particularly in the case of continued strength of the dollar.

SIXTH DISTRICT - ATLANTA

The pace of economic growth is continuing to slow in the Southeast. For the first time in several months, job growth did not outrun labor force increases and the unemployment rate stabilized. However, a number of industries remain quite strong, including some textiles, paper, and the full gamut of auto-related manufacturing. Consumer spending, and especially auto sales, is growing briskly, but signs of weakness are surfacing in housing and related markets. Mortgage commitments and lending activity at financial institutions have weakened. Tourism is showing growth from a year ago, but attendance has been far below expectations at the New Orleans' World's Fair. Excessively dry, hot weather again threatens southeastern farm incomes.

Employment and Industry. The unemployment rate in the District edged upward to the nation's rate in April after declining in each of the five preceding months. Florida's unemployment rate increased in both April and May, after posting its lowest rate in nearly a decade in March. A slowdown in construction and production for national defense weakened Florida's labor market. Softening housing demand has adversely affected construction employment in much of the region and cut the demand for lumber used by building materials and furniture industries. Reorganization of the Tennessee Valley Authority and a scaling down of construction of power-generating facilities have trimmed that government agency's employment in the region. In Georgia, 500 jobs have been lost from the closing of denim-producing textile mills due to shifting consumer demands.

Despite the softening of overall labor market indicators, some industries are quite strong and prospects for others are improving. Some segments of the textile industry, notably carpets, are performing well, and the paper industry is operating a 45-48 hour workweek, thanks to a high volume of orders and backlogs. Booming new-car sales have induced a lengthening of the workweek and spurred investment spending at plants supplying the automobile industry. Tire plants are currently on a seven-day workweek and one major manufacturer is purchasing new tire machines in a large modernization program. Moreover, employment at Nissan's plant in Tennessee is expected to expand by 1,000 over the next 12 months with the addition of a car assembly line to its truck assembly operation. By summer's end, 21 of Florida's 22 phosphate mines will be back in production and most workers will have been recalled. Improving oil demand and sharply lower drilling costs brighten prospects for increased activity in the energy sectors of Louisiana, Alabama, and Mississippi. Summer hiring of teenagers, spurred by the Job Partnership and Training Act and private sector initiatives, has been accompanied by a shortage of applicants for available jobs in the fast-food and hospitality industries.

Consumer Spending. According to a poll of merchants, May's retail sales were up over April and year-earlier levels. The region's sales outpaced comparable increases nationally as well. New-car sales in the District were booming in May, although the rate of increase trailed the nation because of the above-average growth of regional sales in 1983. Atlanta and some other metropolitan areas continue to be very fast-growing markets. Reports of weakness are confined to rural areas where farmers remain under financial stress. Non-auto retailers report that seasonal items such as summer apparel, ceiling fans, lawn mowers and other outside tools, and garden furniture are top-selling items. Merchants are ordering fall and winter merchandise with the expectation that sales for the remainder of the year will be healthy.

Construction. Single-family building permits rose 2 percent in April after seasonal adjustment while the nation's permits dropped 3 percent. Alabama and Mississippi, both late to recover from recession, posted the highest growth rates within the District. However, reports from Birmingham indicate a recent sharp reduction in home sales and construction activity. At the same time, Jackson home builders report that a special state financing program for selected home buying is helping them maintain a steady pace of construction. Districtwide, reports from building materials suppliers who experienced heavy sales activity earlier this year now indicate a leveling off or decline in unit sales. Falling prices for lumber also foreshadow a housing construction slowdown.

Nonresidential construction declined by one-fifth in April after rising by more than one-half from February to March. Alabama, Florida, and Louisiana construction slipped most, by 25-30 percent. Birmingham developers report declines in all nonresidential construction, and the completion of large commercial construction projects associated with the World's Fair has slowed activity in New Orleans. Continued rapid growth of nonresidential construction in Atlanta, Nashville, and Orlando mark this region's pockets of strength. Although the planning horizon of developers in these areas has shortened recently, most are going ahead with projects whose planned completion dates are well over a year away.

Financial Services. Unadjusted bank data for May show a decline in the growth of lending activity in the Southeast for the second consecutive month despite a recovery in bank deposit growth from the usual tax-related withdrawals of April. Business and real estate loan growth in May was noticeably weaker than in April while consumer lending increased slightly. Mortgage commitments at the region's savings and loan institutions declined in April. Overall, financial institutions in the Southeast report high levels of liquidity and reasonably good loan demand, but the growth of demand has not kept pace with the growth of deposits.

Tourism. New Orleans' World Fair drew an average of 35,000 visitors per day in its first month of operation, or 1.25 million, well below the 70,000 cited as the break-even attendance average. High prices, delayed construction, and adverse publicity concerning its financing problems have particularly limited attendance by visitors who live within a three-hour drive to the Fair. The low attendance prompted Fair officials to lower the price of season passes by one-third to lure more local and nearby visitors, but daily attendance is still below the break-even level. Neighboring states are benefiting from long-distance tourists on their way to the Fair. Most southeastern visitor centers are enjoying growth in the number of registrations. Air traffic and lodgings industry figures also indicate an increased amount of travel in the Southeast. Southeastern air traffic is up in almost all airports. Atlanta's airport reversed a three-month decline in passenger volume with a 2 percent increase in April.

Agriculture. With favorable weather, District crop farmers are likely to earn higher revenue in 1984 as a result of higher prices and increased plantings. However, dry, hot weather is now plaguing some of the region and, in the absence of a PIK program this year, losses could be heavier than in 1983 if drought continues. In the meat sector, an expected expansion of poultry production will lift total revenue in the poultry industry. For pork and beef producers, high feed costs and continuing low livestock prices have resulted in losses; planned production cutbacks that are proportionately larger than the expected price increases should shrink livestock revenue from a year ago.

SEVENTH DISTRICT--CHICAGO

Summary. Business expansion continues in the Seventh District, but distinct signs in the past four to six weeks indicate that the pace of the rise in activity moderated significantly in the second quarter. Slowing was most marked in residential transactions, both on new and previously-owned structures, where higher interest rates have had their greatest impact. However, slower growth or declines also were noted in demand for steel, nonferrous metals, paper products, building materials, retail trade, and rail traffic. Motor vehicle sales, on the other hand, continue to be limited by availability of preferred models. Except for housing and a few specialized components and products, informed observers do not expect a general economic letdown. There are no signs of panic over a cutoff of Persian Gulf oil, upcoming UAW contract negotiations, or financial crises, domestic or international. A major factor in the slowing in the upswing is a moderating push to build inventories now that most "pipelines" have been refilled. Concern over accelerating inflation has abated, with widespread evidence of stiff competition. Demand for mechanical capital goods has increased, but only "selectively" and to levels generally below, often far below, "good" levels of the past. Employment increases continue but remain disappointing in the District, especially in nonmanufacturing. In the agricultural sector, District farmers caught up on plantings by mid-June, overcoming weather-caused delays earlier in the season.

Chicago and Milwaukee. Purchasing managers in the Chicago and Milwaukee areas reported slower growth in output and orders in April and May. However, order leadtimes continued to lengthen and the pace of the rise in employment remained strong. Both groups characterized their May reports as indicating continued growth for their areas, but at a slower pace.

Housing. Residential transactions have declined and a slump in new activity is believed to be underway, although not yet clearly indicated by available data. Quoted rates on conventional loans have increased, to as high as 15 percent, from 13 percent last spring, thereby pushing some potential buyers from the market. Also, lenders have tightened standards. A group of Chicago-area suburban builders reported new contracts down by half from March to May. There is little development work on new subdivisions in anticipation of a revival of demand. ARMs are being used extensively, exclusively by some lenders, but there is concern that some borrowers have been qualified on the basis of artificially low initial rates. Private mortgage insurers and some lenders have taken steps to stop this practice. Inflows of funds to S & Ls are holding up well, but a large share of these funds is being diverted into governments. S & Ls are making some consumer installment loans, but few have used their authority to enter the unfamiliar field of business loans.

Building Costs. Prices of most residential building materials have increased substantially since the uptrend in construction got underway late in 1982. Meanwhile, most building trades workers have agreed to wage freezes for the second straight year, both because unemployment remains substantial and because of inroads by nonunion contractors. Higher prices for such items as lumber, gypsum board, and building hardware brought forth additional supplies, thereby permitting some fallback in prices. In the past month, there has been a dramatic change in the gypsum board market. Early in the spring local shortages of gypsum board were inducing shipments from domestic areas where supplies were less stringent and from abroad--Canada, Mexico, and Europe. Suddenly, shortages have disappeared and the industry is no longer operating at capacity. The main reason for the abrupt change is not a drop in consumption, which remains high, but an end to the inventory buildup by builders and distributors who had feared spreading shortages. From now on, usage of gypsum board in residential work is expected to peak out and decline, while commercial usage continues to rise.

Retail Sales. District observers question the accuracy of the small estimated 0.2 percent rise in total retail sales for May. Nonetheless, they report general merchandise sales somewhat below budget in recent months. Disappointment has centered on sales of soft goods, especially apparel. Although demand for home computers has sagged, rather than increased as expected, sales of traditional hard goods--most appliances, home improvement items, and recreational equipment--have been excellent. Hot weather in June brought a surge in air conditioner sales and some spot shortages. Overall, retail inventories are characterized as ranging from adequate to somewhat excessive. Prices paid remain in check, partly because of pressures exerted on suppliers by large chains with multiple sources for most items, domestic and foreign.

Capital Equipment. The mechanical capital goods picture has not changed substantially from evaluations offered in earlier "commentaries". Output of heavy trucks and trailers remains at capacity with backlogs extending into 1985. Heavy truck capacity, which had been reduced in the recession, is not being rebuilt. Orders for locomotives and freight cars have increased, and are expected to continue to increase, but remain far below prosperous levels. Demand for construction equipment and farm equipment is only slightly improved. Machine tool orders are up substantially, but with shipments still deeply depressed, cash flow to this industry remains perilously low. Other classes of capital goods with selective gains include oil and gas development, water transport, food processing, and materials handling. Equipment for mining coal, metallic ores, and agricultural minerals remains near recession lows. Except for paper, U.S. industry's capital outlays in 1984 are heavily concentrated in replacement and modernization rather than expansion. District capital goods producers continue to lament sharp declines in export markets, which are not reviving.

Steel. Leadtimes on steel orders have shortened, partly reflecting the maturing of inventory rebuilding programs in the auto, capital goods, and construction industries, and in steel service centers. Unlike last year, when the July dropoff in steel shipments was less than seasonal, most steel users this year will take their usual July plant-wide summer vacations. Inventory positions then will be closely evaluated, a difficult process when operations are in full swing. Forecasts for steel consumption and shipments have not been altered and continue to call for substantial gains this year. Pressure for effective restrictions on steel imports, including those from LDC nations, are very strong. Despite anti-dumping rules, imports have hit new highs this year. Foreign steel is much less important in the District than nationally, but its availability helps keep prices at depressed levels.

Motor Vehicles. Aggregate data on car and truck output and sales suggest erratic performance this year, with a general levelling. Actually, market vigor is undiminished. Sales data reflect shortages of full- and medium-sized cars, some sports models, heavy duty trucks, and some light trucks and vans. The motor vehicles picture has also been confused by the end of the Japanese quota year on April 1, and some early U.S. car model changeovers.

Crops Largely Planted. After a slow start, crop plantings are being completed a few days sooner than last year and on schedule with historical norms. As of June 10, virtually all of the District's intended corn acreage and about 85 percent of its soybean acreage had been planted. Initial crop stands are mostly rated "good". Weather patterns in July and early August, however, will be the major determinant of ultimate harvests.

EIGHTH DISTRICT--ST. LOUIS

The economic expansion continued during May and early June in the Eighth District but at a generally slower pace and with more exceptions to the upward course. Department store sales were somewhat greater than a year earlier, automobile sales were mixed, and housing sales decreased. Factory orders were up, but at a slower rate as businesses became more sensitive to possible inventory excesses. The general outlook is for further, moderate expansion for the next few months.

Consumer Spending

Sales at District department stores continued to rise in May and early June, but merchants reported a slowdown from the large year-over-year advances recorded in the January through April period. Merchandise at discount stores, however, continued to show large gains and most soft goods were in demand. Air-conditioners sold extremely well, reportedly because of higher incomes, memories of last year's hot season and the beginning of summer. Repair shops and other small service companies generally reported good receipts. Although convention business was improved, restaurants and entertainment businesses reported mixed results.

Auto sales in the District varied among dealers in May and early June. Five dealers reported sales were sluggish; six dealers stated that sales were strong, with one noting that May sales established a record for the agency. Smaller cars sold better than larger models, and truck sales averaged about 8 percent above a year ago.

According to builders and realtors, higher interest rates caused home sales to slow in May and early June. In addition, there were a few interruptions of construction by strikes which may have restrained sales. Most builders, however, will remain busy for several months filling back orders. There has been some new apartment building in the St. Louis area, financed by insurance companies.

Transportation

Rail traffic at two lines was 11 percent higher in May than in the same month a year ago. Most items hauled were up; however, "piggy back" traffic was up only slightly. One railroad reported ordering a new locomotive despite idle capacity because of new fuel efficient engines.

River traffic at the Memphis port during May was about average, while in St. Louis a barge line was liquidated because of lack of business. Petroleum shipments were little changed but grain was slow. Several trucking companies reported that business was down in April and May from a record month in March.

Industrial Production

New factory orders at District firms were greater in May and early June than they were a year ago, but they are not flowing with the same intensity as they were earlier in the year. There has been some softening in orders by auto parts stores and appliance dealers. In addition, a number of firms have trimmed orders with a view to slowing inventory accumulation. A lumber firm cut its production and idled 1,900 workers for a brief period to reduce inventories. Inventories, however, are generally considered near desired levels. Employment has increased moderately, and a few firms have marked up prices. An industrial loan collector reported fewer delinquent loans were being placed with the agency and a larger percentage of funds were being collected than in the comparable period a year ago.

Since March 31, strikes over company attempts to restrain increases for both health benefits and cost-of-living have crippled Missouri lead mining production (nearly 80 percent of the nation's output). The strikes, however, have only had minor effects on the price of lead since there has been a worldwide surplus.

Agriculture

Because of rains, many farmers were late in getting crops planted, some had to replant washed out fields, a number of farmers shifted to soybeans from corn, and a few fields are still idle. Although production will be hampered by the adverse weather, total output is still expected to greatly exceed last year's crop which was reduced shar ly by the PIK program and the severe drought. Since many farmers are reported to be in serious financial condition, especially those who were highly leveraged and suffered from the severe drought last summer and fall, this year's crops are critical to their survival.

Finance

Commercial and industrial loans at 12 relatively large District banks rose at an 8 percent annual rate from the end of April to early June. Real estate loans rose moderately but consumer installment credit declined. Time deposits grew while demand deposits decreased. A few corporate treasurers have expressed concern about banking problems, and have lowered some balances to decrease exposure at any one institution.

NINTH DISTRICT - MINNEAPOLIS

With the exception of the agricultural sector, favorable economic trends continue in the Ninth District. Unemployment rates continue to fall, and both consumer spending and commercial investment continue to grow. Both deposits and loans are up. But the agricultural sector continues to be plagued by bad weather, low prices, and cash flow problems. As a result, smaller cities and towns dependent on agriculture are not faring as well as larger, more diversified cities.

Employment

District labor market conditions continue to improve, partly due to seasonal factors. The Ninth District seasonally adjusted unemployment rate fell very slightly to 6.5 percent in April. While the unadjusted unemployment rate for Minnesota fell from 7.1 percent in March to 6.5 percent in April, analysts attribute most of the decline to seasonal factors. Initial unemployment claims in Minnesota continued to seasonally decline, and average weekly manufacturing earnings there rose. The Minneapolis help-wanted advertising index rose a bit in April. In South Dakota, the unadjusted unemployment rate also fell in April, to only 4.5 percent.

The district is facing some major labor market developments--both positive and negative. Another large bank is moving its credit card operation to Sioux Falls, South Dakota, creating hundreds of jobs, and a home appliance manufacturer is adding a few hundred workers to its plant there. But 6,000 hospital nurses are on strike in the Twin Cities, and a large iron pellet plant in northern Minnesota recently announced that it is planning a shutdown in August.

Consumer Spending

General merchandise sales grew only moderately in May, but sales appear to be firming up in June. One large merchandiser reports that its sales rose only 5 percent between this May and last. In the Minneapolis-St. Paul area, another large merchandiser's May sales were less than expected. Both merchandisers attribute part of the problem to slack summer wear sales induced by cold, wet weather. Both merchandisers also have experienced strong sales so far in June, though. This Bank's director reports are similar. One director says that home appliance sales, while strong, slowed in South Dakota in May. Another director notes that while cold weather in May flattened general retail sales in southern Minnesota, these sales have been picking up so far in June.

Motor vehicle purchases are maintaining the strength apparent earlier this year. Regional managers of domestic auto companies report continuing good performance. One of them expects record second quarter sales and has less than two months inventory of both cars and trucks. Another reports this May's car sales up 22 percent over last May's. Recreational vehicles are selling exceptionally well. While generally good auto sales reports have come from the bigger cities in the Dakotas, the picture is mixed in Montana.

Housing activity appears to have firmed after some bad weather slowed it in March. Twin Cities housing permits and home sales rose sharply in April. A leading mortgage banking firm singled out the Minneapolis-St. Paul area as one of the few areas in the nation in which sales were still gaining. Activity has been strong in larger cities throughout the rest of the district, but slow in agriculturally dependent smaller cities and towns.

Commercial Construction

Commercial construction remains active in cities throughout the district. Builders are expecting a record year in Billings and Bozeman, Montana. A newspaper editor reports a lot of commercial construction in the Fargo, North Dakota, area. A Chamber of Commerce official in Aberdeen, South Dakota, notes that over $2 million in building permits were issued there in May, primarily for commercial projects.

Finance

Both deposits and loans have risen recently in the district. Outstanding commercial and industrial loans at large Ninth District banks rose 3.4 percent throughout May, to a level of $4.4 billion. Total deposits at those banks rose 5.9 percent throughout May. Scattered evidence indicates that deposits are holding up even in some agriculturally dependent regions. Acceptable agricultural loans are becoming increasingly harder to find, though.

Agriculture

Despite some recent crop price increases, the agricultural economy is still being plagued by some low prices, bad weather, and cash flow problems. Corn and soybean prices have risen, but milk and hog prices are still low. A blizzard late in April caused substantial livestock losses in Montana and South Dakota. One Bank director notes that northeastern Montana recently suffered from the worst drought since the 1930s. Torrential rains gave that area some relief, but at the same time destroyed some crops in parts of the Dakotas and Minnesota. Many counties in the district have been declared disaster areas because of this bad weather, thus making farmers eligible for emergency loans. A Bank director recently surveyed agricultural lenders in the Dakotas. Less than 20 percent of the survey's respondents thought that farm cash flows would be better in 1984 than in 1983, which itself was not a good year for many farmers in the district. Accordingly, the majority of respondents expected to deny more credit requests this year than last. Another director notes that dairy operations continue to face severe cash flow problems.

TENTH DISTRICT - KANSAS CITY

Overview. Some apparent slowing in economic activity is reported for the Tenth District, with only moderate growth expected for the rest of the year. While retail sales remain well above a year ago, gains have been mixed in recent months. Few significant inventory adjustments are expected in the months ahead, either for retail goods or materials inputs. With few exceptions, materials are readily available and lead times are stable. Price changes are expected to be minimal for the rest of the year, both at retail and for inputs. Housing starts are expected to be flat or down slightly through yearend, with demand down slightly due to higher interest rates. Loan demand at banks is slightly stronger than last month. A further rise in the prime rate is anticipated but consumer lending rates are expected to remain stable. Inadequate moisture last fall and too much rain this spring have contributed to mixed crop conditions, with row crop planting behind schedule. District bankers are concerned about the increase in farm bankruptcies.

Purchasing Agents. About half of the purchasing agents contacted report that input prices have increased 3 percent or less since June of last year. Most of the remainder report increases of 5 or 6 percent. Few agents have seen significant price increases during the last three months. Input prices are expected to increase 4 to 6 percent during the remainder of the year. Materials inventories are generally reported to be at satisfactory levels. Inventory adjustment has been minimal in recent weeks and no significant changes are expected for the remainder of the year. With few exceptions, materials are readily available, lead times are stable, and bottlenecks in labor and capacity are not apparent.

Retail Trade. Retailers report that year-to-date sales are up some 10 to 20 percent over a year ago but that sales gains have been mixed in the past three months. Men's and women's apparel have been selling particularly well. Inventory levels are slightly high relative to near-term sales expectations, but no significant trimming is planned for the near future. Clearance sales are expected to follow a normal pattern. Prices are reported to be generally flat and are expected to remain so for the rest of the year.

Automobile Sales. Automobile dealers throughout the Tenth District report moderately to strongly improved sales in 1984 relative to last year. Sales of imports and large domestic cars have been particularly strong. Several dealers are concerned about the recent rise in interest rates, but all the dealers contacted report satisfactory credit conditions. Financing is available for floorplanning and buyers can get loans. Dealers have tried to expand their inventories but have been frustrated by a lack of availability. The new import quotas effective since April have provided little relief for the tight import market. The outlook for both domestic and imports sales through 1984 and into 1985 is still very good.

Housing Activity and Finance. Homebuilders report that housing starts thus far in 1984 have exceeded year-ago levels, especially in the single-family category. Starts are expected to remain steady or fall somewhat for the rest of the year. Sales of new homes are below year-ago levels, and prices have increased or remained steady. Homebuilders report that materials are readily available at steady prices, except for increases for sheetrock and cement. Savings inflows at savings and loan associations are largely unchanged from last year and are expected to remain steady through 1984. Mortgage demand has fallen off in recent weeks because of rising interest rates. Steady or increasing interest rates are anticipated through 1984.

Banking. Loan demand at Tenth District banks has increased slightly over the past month, mostly due to increases in commercial and industrial loans and consumer loans. Some respondents note that the demand for auto loans is still quite strong. Residential and commercial real estate loan activity is quite variable, with the average level of loans unchanged. Agricultural loans decreased slightly. Total deposits have risen at the respondent banks. There was an increase in all types of deposits except for conventional NOW accounts, which remained at the previous month's level, and passbook savings accounts, which fell. The prime rate ranged between 12.5 percent and 14.0 percent, with over half of the banks charging 12.5 percent and over 80 percent charging 13 percent or less. Although none of the respondents reported a change in the prime rate in the last month, all report an increase of at least 0.5 percent in the beginning of May. Two-thirds of the respondents expect a further rise in the prime, with the rest expecting no change. Consumer lending rates have risen slightly, with 60 percent of the respondents reporting no change. None of the respondents expect consumer lending rates to change in the near term.

Agriculture. Crop conditions across the Tenth District are mixed. The winter wheat crop is rated from average to good. Some areas of the District received inadequate rainfall last fall, resulting in some wheat acreage being replanted this spring to barley or soybeans. Harvesting of wheat has begun in southern Oklahoma and will begin in the northern half of the state in about a week. Wheat harvesting is expected to begin in mid-July in the western part of the District. Planting of row crops is behind normal in most of the District because of heavy rainfall and some flooding. The corn crop is almost completely planted. More soybeans than usual have been planted due to a late spring and the plowing under of damaged wheat. District bankers express concern over the increasing number of farm bankruptcies that have occurred thus far this year and those anticipated next year.

ELEVENTH DISTRICT--DALLAS

The Eleventh District's strong economic recovery continued. District manufacturers recorded increased orders in all sectors, including the long-depressed oil and gas drilling business. A pick-up in drilling activity and near-normal inventory levels suggest that the prolonged slump in the energy sector is ending. Auto and retail sales continue to outpace last year's performance. Higher interest rates and fears of overbuilding have led to a decrease in permits for residential and commercial construction. Drought conditions are seriously affecting many District farmers.

District manufacturing continued its pattern of growth with strong gains in the production of electronics, primary metals, and nonelectrical machinery. The demand for electronic products related to computer applications is exceptionally strong. Orders of primary metals and nonelectrical machinery continue to be boosted by demand for autos, consumer durables, and even equipment targeted for the energy industry. Industrial firms are refurbishing or adding to their existing space and acquiring new equipment. This has increased expenditures for metal and wood structures, heating and cooling units, and machinery. High levels of construction are continuing to fuel the demand for lumber, concrete, and brick, with some plants running multiple shifts. Respondents are generally optimistic about the economy. However, most do not plan significant inventory increases because of concerns over the possibility of higher interest rates. Some shortages have occured and manufacturers have been forced to increase lead times for orders of steel coils, sheet metal, wire, and cable. Neither the shortages nor strong product demands have had a significant effect on prices because of intense competition.

The number of active drilling rigs in June was 21 percent above the year-earlier level. The rebound in drilling has increased the demand for tubular goods and oil field machinery. Inventories of drill pipe have finally fallen to desired levels, having declined from 6.2 million tons in 1982 to 2.9 million tons in the first quarter of 1984. Producers of oil field machinery are working off their excess inventories. Offshore drilling continues to be a particular source of strength.

Auto sales remain at high levels. Recent interest rate increases have not affected sales much. Shortages still exist for many popular models. Dealers expect the current pace of auto sales to continue because of pent-up demand from consumers who put off purchases during the last recession.

Retail sales continue strong with both soft and durable goods sharing in the growth. Some respondents report inventory controls are being relaxed in the face of this strong demand.

Residential construction showed additional signs of slowing. Fears of overbuilding continue to prompt caution in the multifamily market. Multifamily permits increased sharply in April over March, but the number of permits issued in the first four months of 1984 was 10 percent below the level for the comparable period in 1983. April permits for single family homes were 6 percent below the March figure and 16 percent below the year-earlier level. Respondents cite higher interest rates as motivating the decline in residential construction. Many noted that adjustable rate mortgages have moderated the decline.

After a particularly strong March, office and commercial construction dropped in April. The number of permits issued in April was equal to last year's level, although the value was 25 percent lower. Respondents report that high vacancy rates and recent interest rate increases may lead to further declines in construction. Dallas is an exception. The value of permits issued in Dallas for the first four months of 1984 is 72 percent above the year-earlier level.

Year-over-year increases in loans at the District's large banks continue to exceed 20 percent. The rate of loan growth for saving and loans is averaging about 30 percent on a year-over-year basis. The growth in real estate loans at the District's large banks and Texas savings and loans, however, has slowed. Respondents reported that recent interest rate increases have induced them to be more cautious in real estate lending.

Farmers in about one-half of Texas are plagued by drought. Farms and ranches in this area produce about 44 percent of Texas agricultural cash receipts. Harvests of winter wheat in the drought zone are significantly lower than normal. Other farm income remained stable. Cotton prices increased eight percent in May over April, while wheat, corn, and livestock prices were modestly down.

TWELFTH DISTRICT -- SAN FRANCISCO

In the Twelfth District, the growth of the economy appears to be slowing. Consumer spending continues to display exceptional strength, with both department stores and automobile dealerships experiencing excellent business. Nonresidential construction activity also continues to pick up. But in May, the continued rise in mortgage interest rates further reduced both the construction and sale of new homes. Employment in the manufacturing sector generally has been growing at a slower rate due to the ripple effects of the housing slowdown on such industries as lumber, near full capacity operations in a few industries, and the efforts of firms to hold down unit labor costs. In agriculture, the outlook for significant improvement in farm income in 1984 has deteriorated due to the prospect of excess supplies, aggravated by a decline in exports. In April and May, Twelfth District banks experienced a large outflow of money market deposit accounts (MMDAs) as they held the line on MMDA rates.

Consumer Spending

Throughout the District, consumer spending is reported to be extremely strong. In fact, the rate of growth apparently accelerated in May in contrast to the national pattern. Major department stores in Southern California, for example, experienced an average 19 percent year-to-year gain in sales in May compared with a 14 percent gain in April. In Oregon, respondents describe retail sales as a bright spot in an otherwise sluggish recovery. Sales of apparel have been especially strong, but sales of such durable goods as home electronics (video-recorders, televisions) and housewares also are reported to be expanding at their earlier rapid rate. The high level of new home sales earlier this year is maintaining current sales of furniture and appliances at a strong pace, although some slowdown is expected soon due to the reduced homebuilding and sales pace. Auto sales in May reached their highest level since the late 1970s, supported by the increased availability of foreign and domestic models and subsidized financing by dealers. Consumer installment debt is growing as a percentage of income and retail sales, but loan delinquency rates nevertheless are declining.

Manufacturing and Mining

In most District states, the growth of manufacturing employment has slowed in recent months. In California, employment growth in the manufacturing sector during the past four months has trailed the national gain. There are several reasons for this slowdown. Some industries have been boosting output without a corresponding increase in employment so as to hold down unit labor costs. Others have been cautious about hiring new workers and have relied instead on increasing overtime. Still others -- notably the Pacific Northwest aluminum and paper industries -- are operating at near full capacity. But there also have been some recent layoffs in certain industries. The Pacific Northwest lumber industry has been cutting its payrolls due to the effects of the national homebuilding slowdown in reducing orders and prices for its products. The copper, steel and coal industries in the Intermountain states have been laying off workers due to excess worldwide supplies and rising imports. The most rapid employment gains continue to occur in the electronic equipment and missiles and space industries located in California, Oregon, Arizona and Utah. Electronic firms continue to benefit not only from rising defense and consumer demand but business capital spending to increase efficiency. Other capital goods industries adding to their payrolls include nonelectrical machinery, trucks and firms manufacturing military and commercial transport aircraft.

Construction and Real Estate

Housing starts and sales of new homes in the West are reported to have slowed further since April but relatively moderately considering the current high level of mortgage rates. Respondents attribute the moderate nature of the slowdown to the increased public acceptance of adjustable rate mortgages and the increased offerings of "buy-down" programs by builders. Sales of existing (older) homes actually have continued to increase due to the rise in seller financing schemes. Bankers believe mortgage rates have reached a threshold, however, where even a further 50 basis point rise would have a dramatic negative impact on housing markets. The rise in interest rates has not affected the sharp increase in nonresidential construction projects planned and underway in the West, including new shopping malls, hotels, office buildings and warehouses. In Southern California, an influx of foreign money from Pacific Rim sources is an important source of financing. Firms continue to be cautious about investing in new industrial structures, except for electronic equipment manufacturers.

Agriculture

The outlook for significant improvement in California net farm income in 1984 has become less favorable due to the prospect of overly abundant harvests and break-even prices for certain key crops. Cotton plantings are progressing well, and prices also look favorable relative to a year ago. But the harvest of wheat, barley, alfalfa and other small grains is in full swing at prices that at best just about match those of a year earlier. The harvest of vegetable crops has been outstanding. But demand has lagged behind production, reducing prices for such items as lettuce, broccoli and celery to or below the break-even point for most growers. Similiarly, the huge carryover of raisins and potential excess supply of wine grapes threaten to hold down grape prices. In the Pacific Northwest, the outlook for farm income is less favorable than in California due to the greater importance of grains in the crop mix. In the Pacific Northwest, exports of grain are reported to be running 30 percent below the level of a year ago despite increased sales to China. Throughout the Twelfth District, rising interest rates are placing extreme financial pressure on those farmers who already are highly leveraged.

Financial Institutions

Twelfth District banks experienced a significant runoff in money market deposit accounts (MMDAs) during April and May (nearly $1.3 billion), when market interest rates were moving upward. While not all institutions suffered outflows, the large magnitude of the recent weakness was due to a number of factors. First, loan demand at many banks remains moderate to weak, although total loan growth at large banks has picked up in the second quarter. This slack loan demand has left many banks with an abundance of funds. Without the demand-side pressure, many banks are holding the line on MMDA rate increases to minimize costs and maintain net interest margins. Thus, these conditions have opened a significant rate differential between banks and money market funds, which is causing some of the runoff. A second factor is banks' decision to direct funds from MMDAs and into longer-term certificates by offering higher rates on longer certificates. In addition, a few smaller institutions also have reported that the turmoil in the financial markets has caused depositors to move funds into U.S. Treasury securities. Finally, these factors coincide with the typical seasonal weakness in consumer deposits around the April tax date, as depositors withdraw MMDAs to make their tax payments and transfer funds into IRA/Keogh accounts.